

# Liquor Control Board Three-Tier Review Task Force

## Draft – Meeting Agenda

May 18, 2006

Topic	Purpose	Time	Outcome	Lead by
1. Welcome / Introductions / Agenda	Information	10 minutes (10:00-10:10)	Information	Nate Ford (Task Force Chair)
2. <b>Explain:</b> Voting process <i>and</i>  <b>Summary:</b> Charter changes and charter adoption	Information  Adopt Charter	15 minutes (10:10-10:25)	Information/ Finalize Charter	Nate Ford
3. <b>Discussion:</b> Results of interviews and focus groups	Information	90 minutes (10:25-11:55)	Inform policy discussion and inform vote on change candidates	Sterling Associates
<b>BREAK - LUNCH</b>		35 minutes (11:55-12:30)		
4. <b>Discussion:</b> Continue discussion of state policy goals and strategies	Consideration of high-level criteria	75 minutes (12:30-1:45)	Agreement on high-level criteria as context for Task Force decisions	Sterling Associates
5. <b>BREAK</b>		15 minutes 1:45-2:00		
6. <b>Conclude:</b> policy direction	Information	30 minutes (2:00-2:30)	Information/ Understanding	Sterling Associates
7. <b>Wrap up:</b> and adjourn	Summary and assignments	15 minutes (2:30-2:45)	Information	Sterling Associates

# Task Force Charter

## FINAL DRAFT



## Context:

Introduction and scope of the Three-Tier Review Task Force:

- **Introduction**

The Liquor Control Board (LCB) is responsible for controlling the sale and distribution of alcoholic beverages in Washington State. The current regulatory system has been in place for over 70 years and is designed to meet several key state policy goals:

- ▶ To foster temperance / promote moderation in consumption of alcohol;
- ▶ To assure the controlled, responsible and orderly marketing of alcohol;
- ▶ To promote the efficient collection of taxes; and

Market shifts throughout the industry, significant policy changes driven by recent court decisions and legislative direction, and shifts in public understanding and attitudes about the role of alcohol in our society are prompting a broad-based reexamination of the current regulatory system.

State policymakers, industry leaders, and public health and safety stakeholders are all considering whether changes to the state's current regulatory framework are needed. Since 2001 numerous bills have been introduced in the state legislature proposing to modify various aspects of the distribution of alcohol in our state. To date, proposals have been piecemeal.

On March 29, 2006, Governor Gregoire signed into law Second Substitute Senate Bill 6823. That bill includes a provision directing the LCB to convene a broad-based Task Force whose charge is to conduct a comprehensive review of the current regulatory system controlling the sale and distribution of beer and wine in Washington State, and to recommend what, if any, changes should be made.

- **Initiative Scope**

The Liquor Control Board (LCB) has established this Task Force to contribute to this comprehensive review of the three-tier system, and to provide recommendations for improvements, if needed, to the LCB. The purpose of this review is to identify key issues and concerns about the current system for the sale and distribution of beer and wine, and to determine whether changes, if any, are warranted. The Task Force will:

- Review the impacts of the current regulatory system;
- Consider alternative approaches to achieving the state's goals related to beer and wine distribution; and
- Analyze the costs and benefits of potential alternatives.

The Task Force will produce a final report to the LCB summarizing the results of this effort. The report will include recommendations regarding changes to the existing system, if needed.

The Task Force will focus on four key questions:

1. Are the state's current alcohol sales/distribution policy goals still relevant and appropriate today?
2. What are the current controls and structure for meeting the policy goals related to beer and wine, and are they effective?
3. Is there evidence that the current controls and/or structure significantly impact industry businesses, consumers, society and/or the state?
4. What alternative controls and/or structure are available to meet the state's relevant policy goals and what are their impacts to industry businesses, consumers, society and/or the state?

- **Success**

This review will be successful when these questions are answered, and members of the Task Force provide specific recommendations for improvements, if needed.

## **Purpose of Three-Tier Review Task Force:**

The Three-Tier Review Task Force is convened to provide diverse and informed perspectives, guidance and if needed, recommendations for improving Washington State's regulation of the beer and wine sales and distribution system.

## **Roles and Responsibilities:**

- **Three-Tier Review Task Force**

Members of the Three-Tier Review Task Force are expected to:

- Prepare for and attend Task Force meetings,
- Champion the initiative and help educate other stakeholders,
- Receive and understand background on the history of the state's beer and wine regulatory system, processes and environment,
- Review information provided related to the state three-tier Review,
- Finalize priorities for improvement opportunities as identified by the Task Force (if any), and
- Discuss and if needed, provide recommendations and guidance to the Liquor Control Board for improvements to the state's regulation of the sale and distribution of beer and wine.

- **Liquor Control Board**

The Liquor Control Board will actively participate in the Task Force, recruit and communicate with the participating task force members and agencies, provide staff work and data as necessary, carefully consider any recommendations off from the Task Force, and direct the consultant resources.

- **Sterling Associates, LLP**

Sterling Associates will provide consulting, support and assistance to the Task Force including: preparing Task Force meeting materials; assessing the impacts of the state's current beer and wine sales and wine distribution regulatory system and proposed changes to that system; and documenting the Task Force recommendations for improvements, if any, and next steps.

## **Membership of Three-Tier Review Task Force:**

### **Task Force Chair:**

- Nathan Ford

### **Legislators:**

- Cary Condotta, State Representative
- Steve Conway, State Representative
- Jeanne Kohl-Welles, State Senator
- Linda Evans Parlette, State Senator

### **Industry Representatives:**

- Lynn Gust, Fred Meyer (Large Grocers)
- Mike Hale, Hale's Ale (Washington Brewers)
- Tim Hightower, Washington Wine Institute (Washington Wine Producers)
- Katie Jacoy, California Wine Institute (Out-of-state Wine Producers)
- Steve Lynn, Water to Wine Shop (Specialty Retailer)
- John McKay, Costco (Large Retailer)
- Perry Park (Grocer)
- Shelley Sieveking, Anheuser-Busch (Out-of-state Beer Producers)
- Gene Vosberg, Washington Restaurant Association (On-premises Licensees)
- Phil Wayt, Washington Beer and Wine Wholesalers Association (Wholesalers)

### **Prevention / Treatment / Enforcement:**

- Greg Hopkins, Tacoma Police Department
- Carol Owens, Governor's Council on Substance Abuse
- Mary Segawa, Together!
- Tom Carr, Seattle City Attorney's Office

### **Consumers:**

- Fred Hellberg, Private Citizen

### **Liquor Control Board:**

- Rick Garza

LCB 3-Tier Review Task Force –  
Written Comments Received between May 3 and May 12, 2006

The following written comments were submitted to the Task Force on or before May 12, 2006:

1. Task Force member, Shelley Sieveking, submitted her written response to the discussion topics from the May 3, 2006 meeting. She will be unable to attend the meeting on May 18 and wanted to pass along to the full Task Force her comments on the state's policy goals and supporting strategies.
2. John Guadnola, attorney to the Washington Beer and Wine Wholesalers Association (WBWWA), submitted comments regarding the WBWWA's understanding of the definition and purpose of the "orderly market" policy goal, and their understanding of the underlying principles of the state's current system of regulation.
3. The Washington State Sports and Entertainment Facilities Operators Association (WSSEFOA) submitted a written response at the focus group for sports and entertainment facility operators. Their response discusses the association's concern about the constraints Washington's tied house laws place on advertising – specifically, the restraint on naming rights – and the impact these constraints place on the venues' opportunities to raise revenue.

LCB 3-Tier Review Task Force –  
Written Comments Received between May 3 and May 12, 2006

Jill Satran

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**From:** Shelley Sieveking  
**Sent:** Thursday, May 11, 2006 8:10 AM  
**To:** Kimberly Rau; Jill Satran  
**Subject:** Washington Task Force

Good morning.

As I mentioned, I will not be able to attend the May 18 meeting. I apologize that I cannot be there in person. I am still trying to arrange a designee but since that still looks so uncertain, I wanted to get my thoughts to you prior to the May 12 deadline. I have reviewed the “Draft Results – Working Document” distributed May 10, 2006.

- **Topic #1 – Fostering Temperance**

With regard to Discussion Topic #1, I believe the State’s policy goal to foster temperance and promote moderation in consumption of alcohol is still appropriate and relevant today. I agree with the working interpretation of “responsible consumption by legal adults.” Responsible consumption, by definition, does not result in harm to others. Responsible consumption, by definition, is not misuse of alcohol. Thus, fostering temperance should continue to be a policy goal and the working interpretation “to promote responsibility in consumption of alcohol by legal adults” is a good working interpretation.

- **Topic #2 – Orderly Market**

With regard to Discussion Topic #2, I think the State’s policy goal of controlled, responsible and orderly marketing of alcohol is still appropriate and relevant today. I think it is important that Washington State not abandon an “orderly market” in alcohol as one of its public policy goals. I would like to vote that this goal be continued and if you can share my reasoning with the rest of the group in my absence, I would be most appreciative.

Maintaining an orderly market for the sale of alcohol is one of the States’ core powers under the 21<sup>st</sup> amendment. The United States Supreme Court and Federal Court of Appeals have consistently confirmed this to be the case.

In the context of alcohol, an “orderly market” is not an economic concept. It does not refer to the economists’ idea that “order” means product is neither oversupplied nor undersupplied to a particular market. The concept of an “orderly market” describes the social control necessary to prevent the well-known risks of unregulated alcohol distribution. This is discussed in the Rockefeller Report which was commissioned after Prohibition to establish an effective system of alcohol control.

- **Policy Strategy – Controlling the Flow**

An orderly market controls both the flow of alcohol and access to alcohol. This continues to be an appropriate/relevant strategy. This includes:

- a. Physical control over and ability to track the product;

SIEVEKING COMMENTS (continued)

- b. Controlling who sells the product, and to whom;
- c. Controlling the relationships between different parts of the distribution chain; and
- d. Controlling who buys the product and from whom.

A state has the power to regulate or control the passage of alcohol beverages through its territory in the interest of preventing their unlawful diversion. An “orderly market” is one that is structured to prevent diversion of alcohol into illegal unlicensed, unregulated channels. [Both Rockefeller Reports.]

Diversion is not just a thing of the past. “Diversion activities are . . . defrauding the U.S. of tax revenues. In this case, non-tax-paid cigarettes and distilled spirits are fraudulently claimed for export markets (for which there is no tax liability) when in fact they are illegally diverted back into the U.S. domestic market for sale where taxes should apply.” Illegal distribution of alcohol has also been uncovered in Washington. [ATF Online, “Diversion,” May 4, 2006; Norman Clark, The Dry Years.] The fact that there are not larger numbers of diversions documented may well result from the lack of investigation and enforcement dollars available for alcohol-related illegal distribution.

Diversion of alcohol from the United States into Canada continues to be a substantial problem. This diversion not only deprives the state and federal governments of tax revenues, it also creates unlicensed, unregulated distribution channels through which alcohol can be diverted to an illegal United States market. Similar problems exist in Europe. [Background materials available.]

We also know from bitter historical experience that failing to control the flow and access to alcohol can result in wildly unregulated alcohol distribution, and diversion into illegal channels.

An orderly market also prevents or restricts the illegal manufacture of alcohol. This, too, is also not just a historical problem. In the 1970’s and 1980’s, ATF seized over 6,000 illegal stills and millions of gallons of illegal spirits and its components. [ATF On-line: Illicit Liquor] Illegal manufacture of alcohol will predictably rise as a result of a “disorderly” market.

- **Policy Strategy – Separate the Three Tiers and Ensure a Level Playing Field**

I believe these two strategies are still appropriate and relevant and I think they are overlapping concepts.

An orderly market prevents the undue influence by suppliers and wholesalers over retailers, and vice versa, that can arise through vertical integration. “Order” involves structures and laws that prohibit “the ‘overly aggressive marketing techniques’ that had been characteristic of large-scale alcoholic beverage concerns” before Prohibition. [See Actmedia, Inc. v. Jay Stroh, 830 F.2d 957,959 (9<sup>th</sup> Cir. 1986).

We cannot ignore our industry’s history on this point. One of the primary problems that led to the excesses and abuses before Prohibition was the financial domination of retailers by suppliers. [Rockefeller Report] This is not just a historic concern. On a day-to-day basis, preventing undue financial influence continues to be one of the State’s main tasks.

Tied house laws, which institutionalized the separation of the supplier and wholesale tiers on one hand, and retail tier on the other, were designed specifically to prevent a return to “disorderly markets” characterized by financial intermingling of interests, involvement of criminal elements in the



LCB 3-Tier Review Task Force –

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SIEVEKING COMMENTS (continued)

trade, exclusivity arrangements, distribution of extremely inexpensive or free alcohol beverages, among other things. [See, Dickerson v. Bailey, 87 F. Supp. 2d 691, 703 (D. Tex. 2000)].

Smaller, independent retailers, who make up the bulk of retail licensees in Washington in terms of both number and volume of alcohol sold, still need the State's help in maintaining their financial independence from more powerful suppliers and wholesalers.

And the emergence of powerful retailers actually enhances the need to prevent undue influence – but in reverse. A powerful retail tier can exert undue influence on alcohol suppliers to emphasize production of larger volumes of reduced-price beverages, and at the expense of product variety.

To the extent that the market for beer and wine is not regulated, this risks the return of competitive pressures that led to inappropriate retail sales practices in the past and can lead to them again in the future.

Again, my apologies for my absence. I would appreciate it if you could share this input with the others on the Task Force.

Shelley Sieveking

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LCB 3-Tier Review Task Force –  
Written Comments Received between May 3 and May 12, 2006

**Jill Satran**

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**From:** Guadnola, John [JGuadnola@gth-law.com]  
**Sent:** Thursday, May 11, 2006 12:48 PM  
**To:** Jill Satran; Kimberly Rau  
**Cc:** Phil Wayt  
**Subject:** FW: comments to three-tier review task force

Jill and Kim:

I wanted to follow up on last week's Task Force meeting and the focus group discussion with the members of WBWWA with a few comments.

1. A meaning of "orderly marketing" can be found in the statutes. Specifically, RCW 66.28.180(1) states that the intent of the law is "the orderly and responsible distribution" of beer and wine. The statute goes on to specify that prices are to be posted and held, that prices are to be uniform, that prices must reflect at least the statutory minimum markup, that there are to be no volume discounts, and that all prices are to be delivered prices. Other portions of Title 66 specify that there are to be no sales on credit, no other "money or money's worth" going to retailers, no central warehousing, no sales from retailers to other retailers, no special arrangements with sports facilities or other entertainment centers, and a myriad of other provisions.

The overall thrust of all these provisions is that prices for beer and wine are intended to be relatively uniform and relatively stable, and that beer and wine are to be relatively widely available. Since this is the inevitable result of the current Washington system, and since the legislature said the system was intended to foster "orderly and responsible" marketing, the only logical conclusion one can reach is that the legislature thinks "orderly marketing" is a system that assure relative price stability and uniformity, and relatively wide availability, for beer and wine.

2. At the last Task Force meeting two people questioned why the State had any interest in orderly marketing. It appears to me that they are the only two people who think this is an issue, but it is a significant question.

In my view, the principal benefit of "orderly marketing" is the concept of control. If the market is left unrestricted, it will be extremely difficult for the State to know who is selling what to whom and at what price. That is not a problem with non-alcoholic products but it is potentially a severe problem with beer and wine. Many of the problems one can foresee arising in the context of sales by retailers to consumers will have their origin in the relationship between retailers and distributors or suppliers. As Tom mentioned, when there is price competition among retailers of beer and wine the community encounters problems. That kind of price competition would be facilitated by volume discounts, credit, non-uniform pricing or other marketing practices that would arise if the relationship between suppliers/distributors and retailers were left unregulated. Retailers operating on the edge of solvency, or who choose to operate on the edge of ethical business practices,

GUADNOLA COMMENTS (continued)

would try to take advantage of volume discounts or credit to reduce prices to consumers in order to maximize sales and cash flow.

The potential problems that would result if the ban on credit sales were lifted are a good example of the kinds of concerns that the concept of "controlled" or "orderly" marketing avoids. If wineries are permitted to offer credit, it will be only a matter of days before retailers are demanding credit; this will inevitably result in different customers getting significantly different prices, and the person who has the least need for credit will get the most generous terms. It will also make the small Washington wineries vulnerable to extreme pressure from retailer customers. If, for example, a small winery sells 25% of its production to a big box store on credit, and the buyer delays payment even a small amount, that winery will find itself in a precarious financial position. How will it react if the retailer agrees to pay promptly, and to continue making significant purchases, only if the winery refuses to sell to competitors of the box store? Or if the retailer demands a significant price cut not available to others? This is a hypothetical situation for wineries, but it closely mirrors what has happened to a number of producers of non-alcoholic products.

Similarly, if a marginal retailer were to obtain credit the temptation would be to maximize the impact of its limited cash by using the most credit available. That would put the retailer at risk of ending up indebted to a supplier or distributor to such an extent that the retailer could be coerced into dropping other brands, or into pushing as much beer and wine as possible by lowering prices as much as possible. By the same token, the distributor or supplier would be tempted to turn a blind eye to illegal sales by such a retailer because if the retailer were to lose its license the chance of the distributor or supplier ever recovering the money it advanced on credit would disappear.

The problems that would arise if orderly marketing were abandoned would also extend into the tax-collection arena. For example, if beer and wine manufacturers were permitted to extend credit to retailers tax collection would become more difficult. It is my understanding that, currently, the distributor or the manufacturer functioning as a distributor pays the tax. When the manufacturer is shipping directly to a retailer, the tax is not paid until the product moves from the manufacturer to the retailer. If the manufacturer does not get paid for the product for a few months, or if the retailer goes out of business or otherwise fails to pay entirely, the manufacturer has to make the tax payments out of its own reserves. That could be an enormous burden for smaller wineries and breweries, and the temptation to defer paying the taxes would be great. Actually, whether the manufacturer is large or small, if the system changes so manufacturers do not get cash on delivery and are at risk for the taxes, the ability to pay the tax is diminished and the risk that the state will not get paid goes up. The cash requirement gives the manufacturer the ability to pay the tax due to the state. As to wholesalers, they are required to pay the tax when they receive the product. If the cash requirement were eliminated, they would be at risk of not recovering taxes from the retailer. Even if the payment is made, credit would in essence mean that the wholesaler is advancing the taxes to the state and taking

GUADNOLA COMMENTS (continued)

the risk of not getting paid. Alternatively, the wholesaler and the manufacturer will argue that they should be able to get a refund for the tax if the retailer does not pay, or is very late in paying for the product. In either case, the risk of taxes being paid are reduced and the cost of collecting taxes will go up.

3. We are convinced that one of the overriding principles underlying Washington's approach to regulating beer and wine sales is to make them relatively widely available at reasonable, and reasonably stable and uniform, prices. This is the clear impact of the requirement of uniform pricing, the ban on volume discounts, and other regulations. If there were no regulations on the dealings between suppliers or distributors and retailers other than the requirement of a license, the smaller retailers, particularly those in more remote areas, would be at a severe disadvantage. This could result in many of them going out of business, and could make beer and wine more difficult to obtain. The effects of this would undoubtedly include people driving further to get beer and wine, with the attendant increase in the risk of those people driving under the influence.

Today, the vast majority of the participants in the beer and wine distribution market are honest people who make every effort to comply with the rules and to assure that beer and wine are sold responsibly. However, there are always people willing to act irresponsibly just to make a little more profit. If the relationships between suppliers and retailers were unregulated, the temptations faced by such people would be irresistible. There would be more beer and wine getting into the hands of retailers at low prices, and that would result in cheaper beer and wine prices for consumers. An individual consumer might think that was a good deal (unless he or she happened to get in a wreck on the way home), but it would not be a good deal for society.

Unlike other products, for beer and wine the lowest price to the consumer is not the lowest cost to society.

4. The current system works. The principal reason people today think the system may be antiquated or unnecessary is the fact that there have been relatively fewer problems with alcohol in the last 70 years than was historically the case before that. In our view, it is impossible to divorce that fact from the existing regulatory structure, most of which has been in place since 1934. One might speculate on other reasons for Washington having both a relatively high percentage of adults who drink (compared to other states) and at the same time relatively low per capita consumption. However, it would be folly to discard the current regulatory system on the basis of such speculation.

LCB 3-Tier Review Task Force –  
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**Washington State Sports & Entertainment Facilities Operators Association (WSSEFOA)**

**Response to Liquor Control Board Three-Tier System Review**

The WSSEFOA is comprised of venues across Washington State, including Key Arena, Safeco Field, Qwest Field, Tacoma Dome, Spokane Arena, Everett Events Center, White River Amphitheater, and Emerald Downs. Collectively these venues safely host millions of customers a year, in the business of providing sports and/or entertainment events for the public. Ancillary activities associated with our primary business include the provision of food and beverage.

Because of the nature of the services provided, sports and entertainment venues in Washington State hold a specific "sports and entertainment facilities" liquor license. This is a different license from that held by restaurants, bars, or nightclubs.

Although it might appear on the surface that sports and entertainment facilities are not affected by the three-tier system – originally designed to prevent over consumption and block any one entity from monopolizing the system – we are indeed impacted by the "tied house" regulations.

Specifically, the tied house regulations prevent us from accessing certain revenue streams, in particular the naming of areas in our facilities (or the facilities themselves) by a manufacturer or distributor of alcoholic beverages – as the regulations are currently written, there can be no Coors Field or Budweiser Lounge in Washington State.

Our counterparts in many other states CAN and DO enter into partnership and naming rights arrangements with alcoholic beverage providers. The alcoholic beverage manufacturers desire a presence in sports and entertainment venues for branding purposes as part of an overall marketing strategy. There are many successful examples, and these venues also continue to serve a full variety of products to their customers, negating the concern that naming rights and partnerships imply an exclusivity that leads to monopolization or lack of competition. In addition, many of these partnerships include considerable commitment to safe alcohol management (for example: designated driver programs and public service announcements and campaigns), assisting in the goal of preventing over consumption.

Sports and entertainment venues are extremely expensive to operate and we continually search out new and creative ways to increase revenues and pay the bills. It is frustrating that in Washington State considerable revenues are made unavailable to us due to the tied house regulations. National advertisers take their money and spend it in venues in other states. It is important to us that these revenues have an opportunity to remain here in our Washington State venues. Generally sports and entertainment venues in this state have some level of public support – either in construction or operation – and the greater our ability to generate private sponsorship revenue, the less future public burden there may be.

Our proposed solution is that as a result of this review process, sports and entertainment facility license holders should be deemed exempt from the advertising regulations inherent in the tied house/three tier system.